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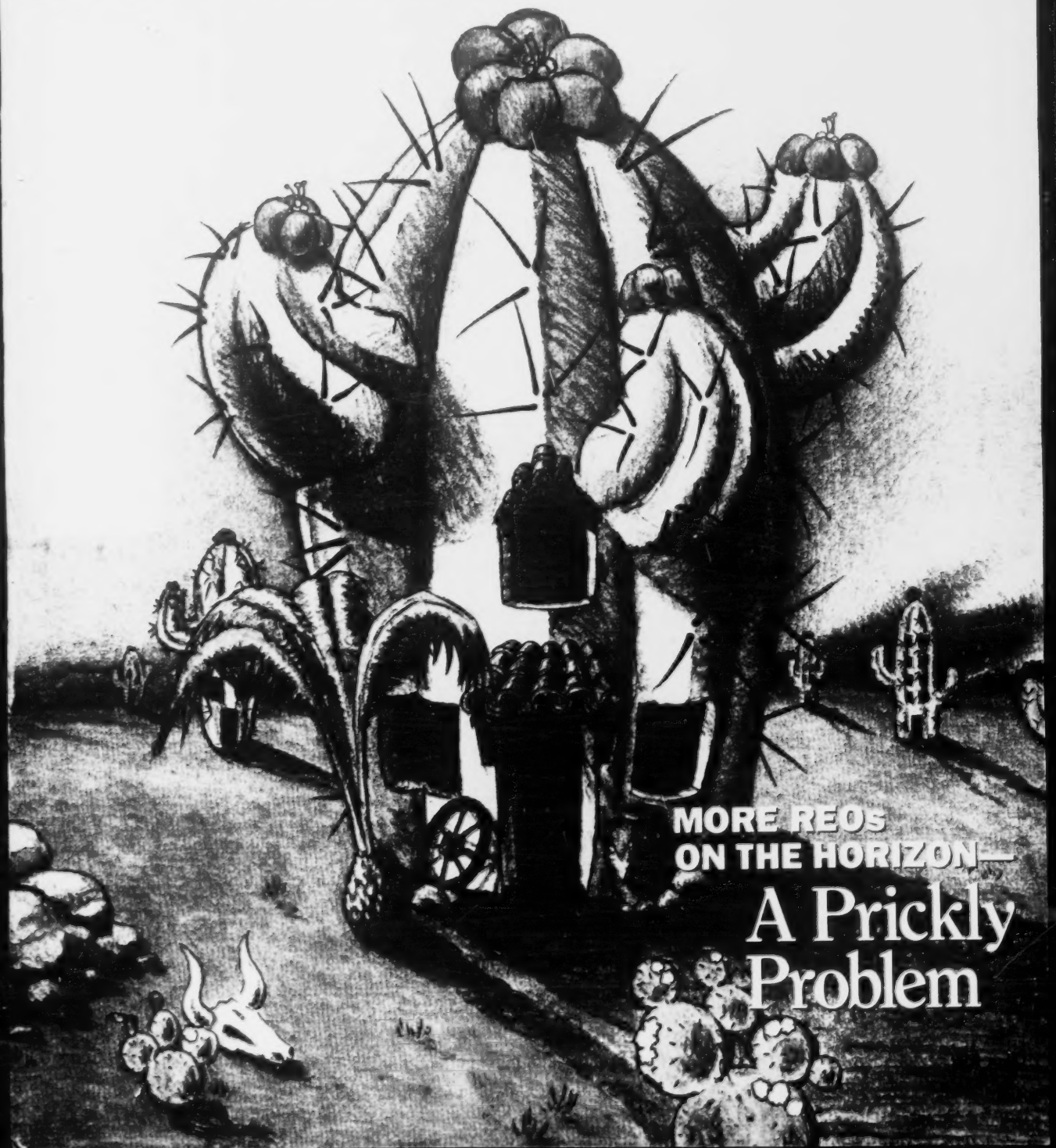
MORTGAGE BANKING

THE MAGAZINE OF REAL ESTATE FINANCE



MORE REOs ON THE HORIZON— A Prickly Problem

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JUNE 1989 VOLUME 49 NUMBER 9

COVER: Servicing

Lenders in the Southwest should brace for a whole new crop of REOs. Government efforts to shut down insolvent thrifts could spring a new supply of foreclosed properties on already soft markets like Phoenix. The likelihood that this will further weaken property values is just one more thorny issue servicers must contend with in this year of major change.

16 Southwestern REOs: A Thorny Problem *A possible domino effect could result from any large-scale liquidation of REOs held by thrifts being closed by the government. A firesale of Southwestern REOs could further erode property values and drive marginally solvent thrifts under.* By RON BARBIERI AND STEVE RANDALL

26 Servicing—A Risky Line Item *With servicing finding its way onto the balance sheet increasingly, ways to hedge this shifty line item become important.* By HAL HINKLE AND BILL GRATHWOHL

38 Servicing Risk: Managing Uncertainties *Spotting potential default risk early is the hallmark of superior servicing managers. Knowing where to find the red flags that signal trouble ahead is key.* By HUNTER WOLCOTT

49 Talking Servicing With Lomas' Glasgow *Many servicing executives have been waging an all-out war on costs in the wake of 1987's bleak performance. Bill Glasgow talks about what his company and others have done to turn things around.* By JANET REILLEY HEWITT

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67 Rethinking Originations *Shorter processing time will be essential in the 1990s. The whole origination process needs rethinking to find the key to fast loan approvals.* By GREGORY P. HACKETT

77 Prevailing Winds: Laboring with Less *Mortgage executives should staff origination jobs with appropriately skilled employees. Using high-priced staff for low-skilled jobs is a costly management mistake.* By RICHARD E. WILKES

Secondary Market

81 The Search for a Better Mortgage Hedge *The Chicago Board of Trade is launching new contracts this month to help mortgage lenders hedge. Backers of the new contracts hope this third attempt to design a workable mortgage hedge will be the charm.* By RALPH D. VERMILIO

Executive Essay

87 Loan Quality is Job One *Why do some lenders still compromise what most concede is the basic principle of successful mortgage banking?* By JAMES R. CARROLL, CMB

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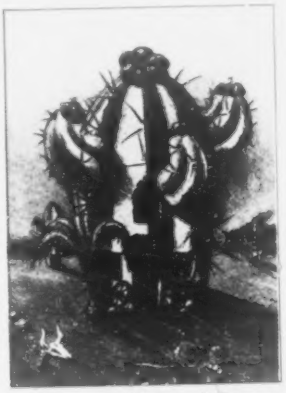
COVER ILLUSTRATION BY LINA CHESAK

REOs on the Southwestern Horizon



Like the cactus, with its formidable thorns and beautiful flowers, the thought of more REOs sprouting up in the Southwestern landscape has both good aspects and bad.

But for lenders trying to put the brakes on declining property values to preserve the value of REO portfolios, the thought of more foreclosed properties being dumped on the market has mostly bad aspects. Granted, the regulators are dealing with a thorny problem here. These institutions will end up costing the federal government and taxpayers more money with every passing day that these necessary liquidations are put off. But the key question is whether the regulators will be seeding the ground for a whole new crop of thrift failures by flooding the market all at once with still more REOs, thus sending prices still further southward.

But for long-term investors in both residential and commercial properties, there are value investments galore in Arizona and Texas real estate. The federal regulators closing down failed thrifts will almost certainly increase the buying opportunities there for investors. When the dust settles, buyers are likely to pick up good values for any type of property under the sun.

This month's cover story will not resolve any of the REO policy questions tied to the insolvent thrift closings. But the article should be of interest to servicers with REOs and delinquent loans in Arizona and Texas. Other servicing topics covered in this issue are: ways to hedge servicing assets that wind up on the balance sheet; servicing risk management techniques and clues to spotting potential default risks; and an interview with the head of servicing at Lomas.

Other hot topics covered in the June issue are: mortgage pricing and how to price in a financially informed way; a blueprint for re-examining originations with an eye toward short-circuiting delays in loan approvals; a program for dividing the labor in loan production to avoid misusing high-priced loan officers; and a piece on the debut of some new mortgage futures contracts at the CBOT.

Janet Reilley Hewitt
Editor

COMING IN JULY

What's the Big Deal?

Standard & Poor's rating expert will size up how big the deals have gotten in the gradually growing market for commercial mortgage securities. How large has that market become and can it live up to its early promise? Next month's offerings will also include a piece forecasting job growth and population migration among the nation's metro markets—who's on the map and who's off in terms of future demand for office and retail space.

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VITAL STATISTICS

INTEREST RATES & YIELDS
1- TO 4-FAMILY MORTGAGES

	FHA OPINION SURVEY	FHLBB			FNMA		FHLMC	
1989	FHA New Homes[1]	CONVENTIONAL[2] FRM	ARM	Median Cost of Funds FSLIC Institutions	1-Yr. ARM	FRM Conv.	ARMs	FRMs
JAN	10.75%	10.60%	8.80%	7.52%	9.48%	10.59%	8.55%	10.73%
FEB	10.79	10.80	9.07	NA	9.64	10.65	8.65	10.65
MAR	11.02	10.83	9.24	NA	10.07	11.09	9.09	11.03
APR	**NA**	**10.93**	**9.45**	**NA**	**9.80**	**10.94**	**9.40**	**11.05**

SELECTED SECURITIES

			U.S. GOVERNMENT				
1989	FEDERAL FUNDS RATE	PRIME COMMERCIAL PAPER (3-Month)	6-Month	1-Year	3-Year	10-Year	A-Rated Utility
JAN	9.12%	9.04%	8.36%	9.05%	9.20%	9.09%	10.09%
FEB	9.36	9.37	8.55	9.25	9.32	9.17	10.25
MAR	9.85	9.95	8.85	9.57	9.61	9.36	10.37
APR	**9.84**	**9.81**	**8.65**	**9.36**	**9.40**	**9.18**	**10.33**

CURRENT SECONDARY MARKET YIELDS

1989	GNMA[3]	FNMA[3]	FHLMC[3]
JAN	10.34%	10.30%	10.30%
FEB	10.37	10.33	10.33
MAR	10.63	10.58	10.57
APR	**10.58**	**10.55**	**10.54**

SPREADS
(Basis Points)

	GNMA	FNMA	FHLMC
	Minus 10-Yr. Govt.	Minus 10-Yr. Govt.	Minus 10-Yr. Govt.
JAN	125	121	121
FEB	120	116	116
MAR	127	122	121
APR	**140**	**137**	**136**

SECONDARY MARKET ACTIVITY
(Dollars in Millions)

	FNMA				FHLMC				GNMA	
	Portfolio		Mortgage-Backed Securities						Pass-Through Securities	
1988	Commitments	Purchases	Out-Standing	Issued	Commitments To Sell	Commitments To Buy	Mortgages Purchased	Mortgages Sold	Applications	Issued
DEC	$1,350	$1,726	$178,250	$5,434	$5,888	$10,101	$5,842	$5,511	$3,719	$4,856
JAN 1989	1,087	1,037	180,822	4,074	3,492	5,206	3,586	3,408	4,830	4,584
FEB	3,557	905	184,209	4,811	6,360	8,411	5,088	4,900	2,000	3,990
MAR	**1,771**	**1,469**	**188,071**	**5,473**	**NA**	**NA**	**NA**	**NA**	**5,620**	**3,902**
1988 TOTAL	23,435	23,110	---	54,878	41,271	70,669	44,075	39,777	58,579	56,532
1987 TOTAL	25,415	20,531	---	63,230	68,210	76,615	76,840	75,018	116,611	96,983
3 MONTH AVG.[4] 1989	2,138	1,137	---	4,786	4,926	6,809	4,337	4,154	4,150	4,159
1988	2,864	2,224	---	2,742	2,174	4,142	2,731	2,123	2,934	3,532
1987	1,555	1,253	---	5,227	8,129	7,997	7,956	8,030	12,158	10,178

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES

(Units in Thousands, Seasonally Adjusted Annual Rates)

	BY TYPE OF UNIT						BY REGION							
	HOUSING STARTS			BUILDING PERMITS			HOUSING STARTS				BUILDING PERMITS			
1988	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Northeast	Midwest	South	West	Northeast	Midwest	South	West
DEC	1,577	1,206	371	1,566	1,162	404	201	343	609	424	207	357	566	436
JAN 1989	1,678	1,265	413	1,507	1,140	367	293	313	642	430	227	293	573	414
FEB	1,476	1,090	386	1,415	1,084	331	226	278	573	399	205	300	521	389
MAR	**1,397**	**1,042**	**355**	**1,221**	**940**	**281**	**149**	**307**	**546**	**395**	**180**	**243**	**448**	**350**
1988 TOTAL	1,488	1,140	348	1,463	1,083	380	235	274	575	404	234	269	548	413
1987 TOTAL	1,621	1,212	409	1,535	1,114	421	269	298	634	420	272	282	575	406
3 MONTH AVG. (SAAR)														
1989	1,517	1,132	385	1,381	1,056	326	223	299	587	408	204	279	514	384
1988	1,477	1,153	324	1,384	1,059	326	301	249	543	384	276	256	500	353
1987	1,779	1,325	454	1,687	1,239	448	307	378	624	469	305	349	592	441

HOME SALES

(Units in Thousands)

	EXISTING HOMES			NEW HOMES		
1988	Sold (SAAR)	Available for Sale	Months Supply At Current Sales Rate	Sold (SAAR)	Available for Sale	Months Supply At Current Sales Rate
DEC	3,920	2,160	6.5	674	366	6.7
JAN 1989	3,550	2,400	8.1	694	370	6.5
FEB	3,480	2,450	8.5	621	375	7.6
MAR	**3,330**	**2,510**	**9.1**	**587**	**376**	**7.8**
1988 TOTAL	3,594	---	---	676	---	---
1987 TOTAL	3,526	---	---	671	---	---
3 MONTH AVG. (SAAR)						
1989	3,453	---	---	634	---	---
1988	3,250	---	---	630	---	---
1987	3,640	---	---	726	---	---

VALUE OF NEW PRIVATE CONSTRUCTION PUT IN PLACE

(Units in Billions of 1982 Dollars, Seasonally Adjusted Annual Rates)

	Total[5]	1-Unit	2+ Units	Nonresidential
	$288.6	$107.5	$18.9	$78.4
	290.0	108.1	19.6	81.6
	286.8	107.2	20.3	81.1
	291.7	**105.2**	**20.4**	**84.3**
	281.8	103.5	19.3	77.9
	283.0	100.7	22.4	78.2
	289.5	106.8	20.1	82.3
	279.1	102.7	20.0	77.1
	281.8	99.0	24.7	76.1

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED
By Type of Institution and By Type of Unit
(Dollars in Millions)

1988	1-4 UNITS Total[6]	Mortgage Bankers	Savings & Loans[7]	Commercial Banks	Life Companies	5+ UNITS Total[6]	Mortgage Bankers	Savings & Loans[7]	Commercial Banks	Life Companies	NONRESIDENTIAL Total[6]	Mortgage Bankers	Savings & Loans[7]	Commercial Banks	Life Companies
OCT	$30,578	$6,273	$16,053	$7,586	$332	$2,707	$327	$1,559	$344	$247	$15,669	$84	$2,037	$10,501	$2,936
NOV	28,138	5,430	14,704	7,314	352	3,406	600	1,605	659	271	11,252	23	1,496	6,546	3,090
DEC	32,145	6,459	16,502	8,356	455	4,686	404	2,450	874	628	20,455	224	2,389	11,859	5,879
1989 JAN	**25,935**	**5,286**	**12,352**	**7,754**	**197**	**2,898**	**561**	**1,433**	**396**	**253**	**11,576**	**121**	**1,604**	**7,598**	**2,189**
1988 TOTAL	374,401	85,307	186,237	95,474	3,190	37,876	4,526	20,379	6,988	3,553	175,754	1,032	22,953	119,942	29,714
1987 TOTAL	449,544	110,093	208,054	124,551	3,209	44,981	2,409	22,492	8,299	3,547	168,652	2,871	25,613	110,490	28,160
1 MONTH AVG. 1989	25,935	5,286	12,352	7,754	197	2,898	561	1,433	396	253	11,576	121	1,604	7,598	2,189
1988	21,452	5,742	9,672	5,693	32	2,269	160	1,449	432	81	13,803	17	1,593	10,609	1,473
1987	33,359	8,791	13,193	1,902	221	3,779	529	1,576	658	132	8,999	428	1,569	5,764	1,174

MORTGAGE INSURANCE
(Units in Thousands, Dollars in Millions)

	APPLICATIONS RECEIVED (Units) TOTAL	FHA[8]	VA	PRIVATE	LOANS INSURED TOTAL Units	TOTAL Amount	FHA Units	FHA Amount	VA Units	VA Amount	PRIVATE Units	PRIVATE Amount
1988 DEC	116	58	18	40	106	$7,852	57	$3,502	18	$1,368	31	$2,982
1989 JAN	107	60	16	31	121	8,656	76	4,629	17	1,240	28	2,787
FEB	114	68	15	31	93	6,817	56	3,509	16	1,223	21	2,085
MAR	**147**	**86**	**16**	**45**	**95**	**7,142**	**51**	**3,189**	**18**	**1,364**	**26**	**2,589**
1988 TOTAL	1,755	949	211	595	1,334	98,012	699	42,577	211	15,771	424	39,664
1987 TOTAL	2,340	1,211	408	721	2,282	159,668	1,320	81,881	451	33,312	511	44,475
3 MONTH AVG. 1989	123	71	16	36	103	7,739	61	3,776	17	1,276	25	2,487
1988	140	83	15	42	106	7,517	59	3,577	18	1,342	29	2,598
1987	253	154	44	55	197	13,598	112	6,898	47	3,463	38	3,237

NA—Not Available. SAAR—Seasonally Adjusted Annual Rate.
[1]Secondary market gross yields. Numbers shown for each month are the average of yields from the first day of the month shown and the first day of the subsequent month.
[2]Effective rate on loans closed.
[3]Securities for 0 to 30 day delivery.
[4]Average covers one month less for FHLMC.
[5]In addition to the categories of private construction shown, the total also includes these categories: residential improvements, railroads, electric light and power, gas, telephone and telegraph, petroleum pipelines, and farm nonresidential.
[6]In addition to the categories shown, the total also includes private pension funds, private MBS conduits, state and local retirement funds, Federal credit agencies, mortgage pools, and state and local investment agencies.
[7]Savings & Loans and Mutual Savings Banks.
[8]FHA applications received includes the Direct Endorsement Program.